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Mr. William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, DC 20554

Re: CC Docket No. 96-45 FEDERAL-STATE JOINT BOARD ON  
UNIVERSAL SERVICE

Dear Mr. Caton:

Enclosed is an Original and twelve copies of the Maine Public Utilities Commission and Vermont Public Service Board ex parte presentation made by various staff members of the Commission on April 22, 1997, in the above docket. Please date stamp one copy and return in the enclosed self-addressed stamped envelope.

Sincerely,

Joel Shifman

cc: International Transcription Service  
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**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of  
Federal-State Joint Board on  
Universal Service

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CC Docket No. 96-45

**EX PARTE COMMENTS OF:**

**THE STATE OF MAINE PUBLIC UTILITIES COMMISSION,  
THE STATE OF VERMONT DEPARTMENT OF PUBLIC SERVICE AND  
THE STATE OF VERMONT PUBLIC SERVICE BOARD  
REGARDING THE SUFFICIENCY OF FEDERAL UNIVERSAL SERVICE SUPPORT.**

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The Commission is debating how it will fund programs needed to carry out its universal service obligation under section 254 of the Telecommunications Act of 1996 ("Act")<sup>1</sup>. The Chairman on at least one occasion has indicated that the new "proxy models" recently developed for this purpose are not sufficiently reliable. This will force the Commission to rely, at least in part, upon reported costs of existing carriers. In this *ex parte* filing, the Maine Public Utilities Commission, the Vermont Department of Public Service, and the Vermont Public Service Board present their view of how reported cost data should be used to define parameters of the new federal program. We have also calculated the minimum level of universal service fund support necessary for Maine and Vermont in order for the Commission to comply with the comparability requirements of section 254(b) of the Act.

**I. THE COMMISSION SHOULD PROMPTLY IMPLEMENT UNIVERSAL SERVICE MECHANISMS THAT RESULT IN RATES IN RURAL AREAS BEING COMPARABLE TO THOSE IN URBAN AREAS.**

**A. The Commission should ensure that rates in high cost areas are not more than 25 percent higher than in low cost areas.**

The Act requires that the Commission adopt universal service mechanisms sufficient to the purpose of ensuring that "all consumers, including . . . those in rural, insular, and high cost areas, have access to telecommunications and information services . . . at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. § 254(b)(5)(emphasis added). In addition, the Act requires that the mechanism selected to support universal service be "specific, predictable and sufficient." 47 U.S.C. §§ 254(b)(5), (d) (emphasis added).

The Congress did not provide a precise standard on how much difference may be allowed within the scope of reasonable comparability. Clearly, the Act permits there to be some rate differences between rural and urban areas. However, the Act does not state precisely how large those differences may be. A difficult but essential task for the Commission is to develop an operational mathematical definition for this legal concept.

Rates are "comparable" if they are equal, except for relatively minor variations. With larger differences, however, rates will no longer be "comparable" but may still be "reasonably comparable."

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<sup>1</sup> Telecommunications Act of 1996, Pub. L.A. No. 104-104, 110 Stat. 56 (1996).

At some point, rates will become more dissimilar than similar. At that point, where rates in two areas cease to bear any significant relation to one another, they are neither "comparable" nor "reasonably comparable." For example, if the Commission were to adopt a standard allowing rural rates to be 50 percent higher than urban rates, high rate areas would pay so much more than low rate areas, rates would seem more different than they are similar. At that point, the word "comparable" would not apply, no matter how it were modified. At the other extreme, if rates between two areas differed by only a few percentage points, most observers would agree that they were comparable. This would be true even if there is a high probability that rates in high cost areas will be higher than rates in low cost areas.

Of course, there is no single number that defines "reasonably comparable." Rather, the concept probably implies a range of permissible numbers. The filing parties submit, however, that the Commission should adopt an operational definition of "reasonably comparable" rates that allows rates in rural and other high cost areas to be no more than 25 percent higher than rates in urban areas. Such a number would permit rural rates to be not more than one-fourth higher than urban rates. Any greater difference would, we submit, be outside the realm fairly ascribed to "reasonable comparability."

**B. The Commission should use costs, not rates, as inputs to its universal service mechanism.**

Existing local rates and intrastate toll rates are not a reliable basis for measuring the costs actually imposed on customers for telecommunications services. Local rate levels, for example, are extremely dependent on how much of the carrier's non-traffic sensitive investment has been allocated to local service and how much to toll service. In Maine, for example, a very large portion of non-traffic sensitive costs are recovered through toll rates. Although, by all accounts, Maine is a high cost state, local rates are slightly below the national average, but its toll and access rates are extraordinarily high.

The level of High Cost Fund support should not depend upon artifacts of local regulation. Maine's effort to bring its toll and access rates to economically rational levels will be severely compromised if the current system of high cost fund support is perpetuated, or if existing basic rates -- rather than costs -- are used to calculate support.

There are numerous other variables in local rate designs that should prevent the Commission from relying upon any one kind of rate actually charged by a local exchange carrier. Significant factors include the size of the local calling area and whether measured service charges apply for local usage.

Given these weaknesses in measured rates, the Commission historically, and the Joint Board more recently, has looked to costs as a proxy for rates. The development of "proxy models" was an effort to design reliable forward-looking cost models. However, if such forward-looking costs are not available, then the Commission should rely upon reported costs, as it does today for its universal service support.

**C. The primary responsibility for ensuring "reasonably comparable" rates lies with the Commission, not with the states.**

The Act permits states to adopt universal service mechanisms. These state programs may not be inconsistent with mechanisms selected by the Commission and may not rely on or burden Federal universal service support mechanisms. 47 U.S.C. § 254(f).

The authorization for state programs does not reduce the Commission's responsibilities to achieve the goals identified in the Act. In enacting section 254, Congress did not intend that rates merely be reasonably comparable within each state. Rather, the Act requires that rates in rural and high cost areas *in the United States* be reasonably comparable to rates in urban areas elsewhere *in the United States*. This places a direct responsibility on the Commission.

Even if one were to mistakenly accept the view that, as a matter of law, the Commission may rely upon state programs in order to meet the universal service goals of the Act, states may not have the capacity to attain the goals of the Act. States differ significantly in the percentage of their customers who reside in high cost areas. In high cost states, even an ambitious state universal service program may produce nothing more than uniformly high rates within the state. Those rates still might not be reasonably comparable with urban areas in other states, no matter how ambitious the state's program.

This interpretation is consistent with the language of the Act. The Act suggests that state programs be aimed at "additional definitions and standards to preserve and advance universal service within that State." This does not suggest that states have responsibility for the goals and standards set forth for the Commission and the Joint Board in section 254(c). Rather, the states are free to establish supplemental programs aimed at "additional" goals, definitions and standards. Such a standard might be, for example, that all ratepayers in the state have "comparable" or "equal" rates.

This is a more ambitious standard than that expressed by the Congress, and one suitable for a state supplemental program funded from revenues generated in that state.

## **II. AVAILABLE DATA PERMIT THE COMMISSION TO MEET THE REASONABLY COMPARABLE RATES STANDARD IN A TIMELY MANNER.**

### **A. Data are available showing the loop and switching cost of all local carriers in the United States.**

In an *ex parte* filing, Bell Atlantic has filed data for each local exchange company in the United States ("Bell Atlantic data"). This filing, made in late March of 1997, reports costs for 1995 based primarily, for large companies, upon NECA and ARMIS data.

The Bell Atlantic filing reported each local exchange company's unseparated per line loop costs, plus an estimated switching cost. The methodology used to develop the per minute switching cost is shown on Attachment A. The monthly per minute switching cost under the Bell Atlantic data is the result of step 4 shown on Attachment A. The results for six states are shown in Attachment C.

The Bell Atlantic data contains unseparated cost for loops, but when estimating switching cost, Bell Atlantic assumed 500 minutes of usage. This is an appropriate number to estimate average local usage, but does not reflect minutes of use for intrastate toll or interstate toll. Thus the Bell Atlantic data reflect unseparated loop cost, but only local switching cost.

An alternative approach can be developed that more closely follows the mandate to eliminate all implicit subsidies. This analysis would develop the revenue requirement of a local exchange carrier for the basket of local, toll and access services. To estimate this number, it is necessary to increase switching cost so as to include a company's total per line traffic sensitive local switching costs. The methodology used to develop the per line switching cost is shown on Attachment B. The monthly per line switching cost under the Alternative data calculation is the result of step 3 shown on Attachment B. The results for six states are shown in Attachment C.

**B. Based upon this data, costs in urban areas are approximately \$16.36 per line per month (or \$21.46 using the alternative method).**

The Bell Atlantic data supplies information about prevailing urban costs. Selecting an appropriate urban sample will require the Commission to exercise judgment. The difficulty arises primarily from the fact that the Bell Atlantic data are geographically organized by "study area." A study area typically includes a mix of urban, suburban and rural areas.<sup>2</sup> This makes it difficult to find a set of carriers in the data set whose costs can help establish the key first fact in the universal service calculation: prevailing costs in urban areas.

The District of Columbia is the single exception. Bell Atlantic Washington D.C., Inc.'s study area is limited to the District of Columbia. To our knowledge, this is the single study area in the nation limited only to an urban area.<sup>3</sup> The loop and switching costs reported for Washington D.C. is \$10.06 per line per month.

While the use of such data would be very favorable for rural areas, the District of Columbia might be atypical. It may be appropriate to examine other areas as well. Based upon examination of telephone serving area maps of various states, it appears that the Bell companies in Illinois, New Jersey and Wisconsin serve predominantly urban areas, although they also serve some suburban and very minimal rural areas as well. Shown below is a table calculating the average reported costs for the Bell companies serving the District of Columbia and these three states.

<u>Company</u>	<u>Cost Per Line Per Month</u>	
	<u>Bell Atlantic Calculation</u>	<u>Alternative Calculation</u>
Bell Atlantic Washington DC	\$10.06	\$17.16
Illinois Bell Telephone Co.	\$14.78	\$19.94
New Jersey Bell	\$18.82	\$23.73
Wisconsin Bell	\$17.32	\$21.87
Weighted Average <sup>4</sup>	\$16.36	\$21.46

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<sup>2</sup> An additional difficulty is that most major cities in the United States are served by former Bell operating companies. These companies' study areas generally show average data as between these large cities and much of the remaining suburban and rural areas in the same state.

<sup>3</sup> Other major cities, such as Rochester New York and Cincinnati, Ohio, are served by independent telephone companies, but these companies typically also serve suburban and rural territories and cannot be used in a sample.

<sup>4</sup> The weighted average calculation is performed in Attachment D.

This table demonstrates that, using the Bell Atlantic data, the average cost for loop and switching cost in urban areas is no higher than \$16.36. Using the alternative calculation, the average cost for loop and switching cost in urban areas is no higher than \$21.46.

This analysis is conservative in at least three ways. First, it assumes that the sample of four study areas represents urban cost. This will overstate costs, however, to the extent that the study areas in the sample include higher cost territories. Second, while the analysis does include switching cost, it overlooks transport costs, which also tend to be higher, per line, in rural areas than in urban areas. Finally, the calculation uses a weighted average, which gives greater weight to large mixed-type areas than to the single purely urban case, Washington D.C.

**C. Using a local cost of \$20.45 as a benchmark (or \$26.82 under the alternative calculation) the Commission can establish reasonably comparable rates between rural and urban areas.**

As was discussed above, to establish reasonably comparable rates, rural costs should be no more than 125 percent of urban costs. Since the Bell Atlantic data show that the cost of providing service in urban areas is not more than \$16.36, the Commission should therefore establish a benchmark for its universal service support mechanisms no higher than \$20.45. Under the alternative calculation, the benchmark for support mechanisms should be \$26.82. This is illustrated in the following table:

	<u>Bell Atlantic Calculation</u>	<u>Alternative Calculation</u>
Weighted Average	\$16.36	\$21.46
Benchmark (= 125% of Average)	\$20.45	\$26.82

Having established benchmarks, it is possible to calculate universal service support. The following table shows this calculation for Maine and Vermont. In each case, the amount of USF support implied by this analysis is also shown.<sup>5</sup>

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<sup>5</sup> This analysis is duplicated in Attachment E.

	<u>Bell Atlantic Data</u>	<u>Alternative Data</u>	<u>% Difference</u>
<u>NYNEX Maine</u>			
Total Cost	\$30.69	\$37.10	
Benchmark	\$20.45	\$26.82	
Support/line/month	\$10.25	\$10.28	
Access Lines	626,602	626,602	
Annual USF Support	\$77,047,802	\$77,294,708	0.32%
<u>NYNEX Vermont</u>			
Total Cost	\$33.72	\$40.53	
Benchmark	\$20.45	\$26.82	
Support/line/month	\$13.27	\$13.71	
Access Lines	310,994	310,994	
Annual USF Support	\$49,527,445	\$51,163,286	3.30%

The preceding table shows that, whether one uses Bell Atlantic data or Alternative data, the amount of support needed by NYNEX in Maine exceeds \$10 per line per month. For NYNEX Vermont, the monthly support needed is more than \$13 per line per month. The table also shows that the data modifications that produced the Alternative data set have only a minor effect on USF support.

**D. The Commission should implement universal service mechanisms promptly after May 8, 1997.**

The Act requires the Commission to establish a mechanism for universal service not more than 15 months after the passage of the Act. 47 U.S.C. § 254(a)(2). That date is May 8, 1997.

Once universal service mechanisms have been defined, the Act does not prescribe a time period for implementation of that mechanism. However, given Congress's aggressive action to establish a decision date, it is reasonable to infer that Congress did not anticipate indefinite delay in implementation of the universal service mechanism.

Maine and Vermont have participated in this docket since the passage of the Telecommunications Act of 1996. We are therefore well aware that a solution to the trilogy of dockets now under consideration is not simple. The issues are very complex, and even interim solutions must be capable of easy implementation.

We recognize that it may be difficult for the Commission to implement immediately a USF program that fully satisfies the comparable rate requirements of section 254(b). The current proxy models may not be sufficiently reliable to be used as a basis for determining the need for USF funds. In addition, some have questioned whether the total company revenue of interstate carriers can be used as a funding base of the interstate USF, and this may need further study and analysis. Finally, we are also aware that additional USF funds may be needed by states less rural than Maine and Vermont if they are to meet the comparable rate standard.

However, we are concerned about how we can meet our obligations as state regulators under section 254(b) without significantly higher support from the federal high cost fund. In our view, if the Commission adopts an interim solution, that solution should provide increased funding to Maine and Vermont, which have costs greatly in excess of urban areas. This action will also allow Maine and Vermont, as well as other similarly situated states, to adjust intrastate rates so as to satisfy section 254(b) of the Act.

One approach to an interim solution is to proceed in three phases:

1. As soon as possible, abolish the distinction between large and small companies, now established at 200,000 access lines. This action would eliminate the distinction between large very high cost companies and small very high cost companies, and would recognize that some large RBOC study areas, like those in Maine and Vermont, have costs which greatly exceed the costs in urban areas.
2. Reasonably soon, re-norm the present system. The new calculation should be based upon each study area's relationship to urban costs, as opposed to average national costs. It should also provide some operational meaning to the statutory phrase "reasonably comparable."
3. Define a process that will, over the longer term, allow for careful evaluation of proxy models and also establish a timetable for evaluating whether and when to shift the system to such a forward-looking cost proxy model.

### III. CONCLUSION

The Commission should promptly implement universal service mechanisms that leave rural areas with unsupported costs not more than 25 percent higher than urban areas. This should be based upon measurement of costs, not rates. The primary responsibility for ensuring "reasonably comparable" rates lies with the Commission, not with the states.

Data are currently available that will permit the Commission to meet the reasonably comparable rates standard in a timely manner. Using Bell Atlantic reported cost data, the Commission should establish a benchmark of \$20.45 per line per month. (If the Commission uses the alternative data, the

benchmark should be \$26.82 per month.) While the USF support required by this analysis may seem large, we believe the amounts are fully justified. Failure to provide support in this range would not comply with section 254(b) of the Act.

Given the large legal and factual uncertainties still present in this policy area, it may be appropriate for the Commission to consider providing a transitional increase in USF funding and to also establish a schedule to implement a level of USF funding that will satisfy the requirements of section 254(b). A workable and appropriate starting point is to eliminate the 200,000 line distinction, and thereby end the existing discrimination against large high cost companies.

**ATTACHMENT A**  
**METHODOLOGY FOR CALCULATING SWITCHING REVENUE REQUIREMENT**  
**-- BELL ATLANTIC DATA --**

**Step 1:** Develop interstate local switching revenue requirement using 1995 ARMIS 43-04 data, column (j):

- a:  $\text{Net Return @11.25\%} = (\text{Row 8040}) * 11.25\%$
- b:  $\text{FIT} = (\text{Net Return} - (\text{row 8010} - \text{row 8013} + \text{row 8015})) * 0.35 / (0.65 - \text{row 8015})$
- c:  $\text{SIT Rate} = \text{row 8000} / (\text{row 8041} + \text{row 8000} + \text{row 8020})$
- d:  $\text{SIT} = (\text{Net Return} + \text{FIT} - \text{row 8010}) * \text{SIT Rate} / (1 - \text{SIT Rate})$
- e:  $\text{Interstate Rev. Req.} = \text{Net Return} + \text{FIT} + \text{SIT} + \text{row 7351} + \text{Row 8005}$   
 $= \text{Line a:} + \text{line b} + \text{line c} + \text{ARMIS 43-04 operating expenses} +$   
 $\text{ARMIS 43-04 other taxes.}$

**Step 2:** Develop total company local switching revenue requirement by dividing interstate revenue requirement (from step 1) by the Part 36 dial equipment MOU (DEM) allocator. The Part 36 DEM Allocator is equal to the Interstate DEM divided by the Total company DEM, as defined by ARMIS 43-04. Specifically:

$$\text{Total Co. Local Switching Rev.Req.} = (\text{Interstate Rev.Req.}) / (\text{Part 36 Dem Allocator})$$

and

$$\text{Part 36 DEM Allocator} = (\text{row 1216, column d}) / (\text{row 1216, column b})$$

**Step 3:** Develop total company local switching cost per MOU by dividing cost developed in step 2 by total company DEM. Specifically:

$$\text{Switching Cost per MOU} = (\text{Total Company Local Switching Rev.Req.}) /$$
$$(\text{ARMIS 43-04, row 1216, column b})$$

**Step 4:** Develop total company local switching cost per month by multiplying the per minute cost by 500 minutes

$$\text{Monthly Switching Cost} = (\text{Switching cost per MOU}) * 500$$

**ATTACHMENT B**  
**METHODOLOGY FOR CALCULATING SWITCHING REVENUE REQUIREMENT**  
**-- ALTERNATIVE DATA --**

**Step 1: Same as Bell Atlantic data.**

**Step 2: Same as Bell Atlantic data.**

**Step 3: Develop per loop switching revenue requirement by dividing result of step 2 by total USF loops. Specifically:**

**Monthly Switching Cost = (Total Company Local Switching Rev.Req) / (USF loops)**

**ATTACHMENT C**  
**CALCULATION OF LOOP AND SWITCHING COST, BY STUDY AREA**

<b>Bell Atlantic Data</b>				
<b>Company</b>	<b>Montly Loop Revenue Requirement</b>	<b>Local Switching Cost per MOU</b>	<b>Local Switching Cost per Loop (500 min)</b>	<b>Total Loop and Switching Rev. Reqmt</b>
C&P of D.C.	\$6.13	\$0.007850	\$3.93	\$10.06
Illinois Bell	\$12.30	\$0.004943	\$2.47	\$14.77
New Jersey Bell	\$16.26	\$0.005103	\$2.55	\$18.81
Wisconsin Bell	\$14.97	\$0.004685	\$2.34	\$17.31
NYNEX Maine	\$26.02	\$0.009348	\$4.67	\$30.69
NYNEX Vermont	\$29.42	\$0.008597	\$4.30	\$33.72

<b>Alternative Data</b>			
<b>Company</b>	<b>Montly Loop Revenue Requirement</b>	<b>Local Switching Cost per Loop</b>	<b>Total Loop and Switching Rev. Reqmt</b>
C&P of D.C.	\$6.13	\$11.03	\$17.16
Illinois Bell	\$12.30	\$7.64	\$19.94
New Jersey Bell	\$16.26	\$7.47	\$23.73
Wisconsin Bell	\$14.97	\$6.90	\$21.87
NYNEX Maine	\$26.02	\$11.08	\$37.10
NYNEX Vermont	\$29.42	\$11.11	\$40.53

**ATTACHMENT D**  
**CALCULATION OF WEIGHTED MEAN COST OF URBAN AREAS**

**Bell Atlantic Data**

	Total Cost	Loops	Weighted Cost
C&P of DC	\$10.06	883,538	8,888,392
Illinois Bell	\$14.78	6,248,531	92,353,288
New Jersey Bell	\$18.82	5,464,366	102,839,368
Wisconsin Bell	\$17.32	2,045,952	35,435,889
Total		14,642,387	239,516,937
Weighted Average	\$16.36		
125% Benchmark	\$20.45		

**Alternative Data**

	Total Cost	Loops	Weighted Cost
C&P of DC	\$17.16	883,538	15,161,512
Illinois Bell	\$19.94	6,248,531	124,595,708
New Jersey Bell	\$23.73	5,464,366	129,669,405
Wisconsin Bell	\$21.87	2,045,952	44,744,970
Total		14,642,387	314,171,596
Weighted Average	\$21.46		
125% Benchmark	\$26.82		

**ATTACHMENT E**  
**CALCULATION OF PROGRAM COST FOR MAINE AND VERMONT**

	<b>Bell Atl. Data</b>	<b>Alternative. Data</b>	<b>% Difference</b>
<b>NYNEX Maine</b>			
Total Cost	\$30.69	\$37.10	
Benchmark	\$20.45	\$26.82	
Support/line/month	\$10.25	\$10.28	
Access Lines	626,602	626,602	
Annual USF Support	\$77,047,802	\$77,294,708	0.32%
<b>NYNEX Vermont</b>			
Total Cost	\$33.72	\$40.53	
Benchmark	\$20.45	\$26.82	
Support/line/month	\$13.27	\$13.71	
Access Lines	310,994	310,994	
Annual USF Support	\$49,527,445	\$51,163,286	3.30%

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